

VERMEER NEWSLETTER

July 2020



THOUGHTS ON 2020

The Halfway Point



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Rarely, if ever, in stock market history have we witnessed such levels of extreme volatility. We wrote in our last year-end review that investors should approach 2020 in a positive frame of mind. As it turned out, the first quarter saw the largest ever fall in world stock markets, followed by an equally powerful recovery the following quarter. To use the old adage - it was truly a game of two halves (or in this case, quarters).

The strength of the recovery also reminded us that equity markets look forwards not backwards. By late March and early April, the mood of the stock market was more along the lines of "what shape will the recovery take?" rather than "how are we going to get ourselves out of this mess?".

There was an element of déjà vu when, as with previous stock market falls, the central banks' cavalry charge came to the rescue. In the US, the Federal Reserve acted swiftly and decisively over mid to late March by buying and underwriting corporate, state and municipal bonds, credit card debt and auto loans, as well as lending directly to corporations and small businesses. They were even propping up the bonds of firms downgraded below investment grade as a consequence of the recession. The money made available to support credit markets stood at an unprecedented \$3trillion. Other central banks joined the charge and in the UK the Bank of England slashed rates to 0.10% and renewed its asset purchase programme. One highly regarded US fund manager commented to us shortly afterwards that the speed with which the policy makers had reacted to this crisis was so much quicker than 2008/09, that the period for which stocks actually looked depressed - and therefore the opportunity to "bottom-fish" - was extremely short.

Although, as is often the case, the first half analysis hides a number of nuances. A lot of large, cyclical companies sensitive to overall levels of economic growth fell sharply in February and March at the onset of Covid-19 and their share prices are yet to recover. **JP Morgan**, the largest and probably most resilient bank in the world, fell from around \$140 to \$80. It still languishes around the \$90 mark. **Royal Dutch Shell**, like all oil majors sensitive to the commodity price, still trades close to its multi-year lows, with a severely impaired dividend to boot but nonetheless probably too cheap to sell. Meanwhile, **Amazon**, now ubiquitous in almost every household around the free world, keeps on making new highs. **Microsoft**, whose IT products and services helped us to work and communicate with each other from home, saw its share price rise by another 30% over the first half of 2020. Indeed, it was Microsoft's CEO, Satya Nadella, who issued the statement of the crisis:

"We've seen two years' worth of digital transformation in two months."

And so it was that the large, growth companies outweighed the old economy shares with the result that, since they constituted larger parts of the stock market in the first place, the headline indices approached previous highs once again. The "value" versus "growth" debate rages on but - so far - at the halfway point in 2020 the growth camp continues to reign supreme. James Anderson, the celebrated growth investor at Baillie Gifford, even had the temerity to suggest in his annual report in May that Warren Buffet was past it by labelling his value investing style as having led to what he termed "an investment tragedy".

In the UK, Boris Johnson's government did all it could to bolster the economy from the devastation caused by lockdown. The new Chancellor of the Exchequer, Rishi Sunak, fresh into the role following Savid Javid's sudden departure in February, unleashed all the weapons available from his fiscal and monetary armoury. These included a furlough scheme that at its peak was costing the UK taxpayer around £14bn per month and even, announced in the recent summer statement, the novel concept of issuing £10 food and drink vouchers to support the devastated hospitality industry. The level of debt on government balance sheets around the world has ballooned; and in an environment where the supply side remains constrained and consumers return to spending, higher levels of inflation - the likes of which we have not seen for some time - could be the inevitable conclusion.

China meanwhile, where the virus originated from, outperformed other emerging markets and saw a noticeable appreciation in its currency. For a short while it looked like the Communist Party's inability to form adequate responses to the early stages of the pandemic could shake its very existence to the core; however, a few months on and the Chinese economy remains strong and it continues to form an important part of overall global growth. Relations with the US remain shaky and it has become apparent that were Trump to lose the election (a scenario that has become more plausible in recent months) a Biden administration would continue the anti-China rhetoric.

Finally, following a decade of falling bond yields and just as we had reached the point where investors felt that rates could not go any lower, the emergence of Covid-19 rewrote the playbook: in the wake of the pandemic, rates in the US, UK and the rest of the developed world fell to close to zero. By the end of June the 10 year gilt yielded just 0.20%, shorter dated gilts

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were trading at negative yields and Bank of England base rate was at 0.10%. Once again, ultra-low interest rates remain supportive of other risk assets. While companies whose business models have been largely unaffected, or even bolstered, by Covid-19 laze nonchalantly around their recent highs, many other parts of the market are still pricing in a long road to recovery.

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